



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

DRAFT

Date Introduced:	02/27/09	Bill No:	AB 1332
Tax:	Property	Author:	Salas
Related Bills:	AB 1344 (Fletcher)		

BILL SUMMARY

This bill would expand the taxable possessory interest property tax exemption available to private contractors that operate military family housing projects to those that operate housing projects for single enlisted service members.

It would also refine and expand upon the requirement that the property tax savings from the exemption inure solely to the benefit of the residents of the military housing projects.

Furthermore, it would also detail the documentation and information that the assessor may request from the private contractor to administer the exemption.

ANALYSIS

CURRENT LAW

Section 107.4 of the Revenue and Taxation Code provides that a private contractor's interest in rental military *family* housing is not subject to property taxation as a taxable possessory interest, provided certain requirements and conditions are met.

Subdivision (m) of Section 107.4 provides that any reduction in property taxes, or, if unknown, the contractor's reasonable estimate of property tax savings, inures solely to the benefit of the residents of the military housing through property improvements, such as a child care center provided by the private contractor.

The purpose of this provision is to ensure that the property tax exemption extended to the private contractor of the military family housing project is not merely a windfall savings to the private contractor, but rather that the property tax savings are ultimately passed through to benefit the residents of the military family housing project.

PROPOSED LAW

Bachelor Housing. This bill would amend Section 107.4 to delete the word “family” throughout its text. Thus, the exemption would also apply to the privatization of unaccompanied housing (i.e., housing for single enlisted service members). In practical application this bill would apply to property located in San Diego County, the site of the nation’s first large-scale privatized housing community for unaccompanied military personnel.

Property Tax Savings. In addition, this bill would designate former subdivision (m) of Section 107.4 as paragraph (13) of subdivision (a) related to the requirement that the property tax savings resulting from Section 107.4 are to inure solely to the benefit of the residents of the military housing project through improvements provided by the private contractor. This bill would provide greater specificity of these requirements and expand allowable uses of funds on improvements for:

Improvements – Includes Renovation and Refurbishment. The amendments would expand upon the types of improvements that could be constructed with the

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property tax savings and expressly provide that the property tax savings could be used to renovate and refurbish these improvements. §107.4(a)(13)

Improvements – Community vs. Housing. The amendments distinguish between “community improvements” and “housing improvements.” §107(a)(13)(A)(i) and (ii) It also expressly allows the savings to be used to build more rental units to serve more military personnel, but clarifies that the number of units built must exceed the contractual number of units required to be constructed in the first place. §107.7(a)(13)(A)(ii) and (B)(ii)

Time Frame to Spend Savings. The amendments provide that the annual property tax savings to be spent on improvements (or the renovation and refurbishment of those improvements) from any one year are to be spent within 4 years. §107.4(a)(13)(B)(i)

Beyond Contractual Requirements. The amendments expressly provide that the funds expended on the housing project are to be “over and beyond” the contractual obligation to build, manage, and maintain the housing project. §107.4 (a)(13)(B)(ii)

Providing More from the Beginning. The amendments provide that the property tax savings that will be realized over the term of the lease (typically 50 years) can be used to construct (or secure financing for) community or housing improvements as part of the “initial construction of the project.” §107.4 (a)(13)(C) “Initial construction of the project” is defined to mean “construction completed within the first four years of the term of the lease”. §107.4(a)(13)(D)(ii) But the private contractor and the assessor can agree to extend the time period for an unlimited number of years, as specified. §107.4 (a)(13)(C)(ii) If the timeframe considered to be within “the initial construction period” is extended, then the statute of limitations to make escape assessments in the event the private contractor does not qualify for the exemption is similarly extended. §107.4 (a)(13)(C)(iii)

Estimating Property Tax Savings. This bill provides that when the private contractor must estimate the amount of property tax savings, the estimate will be made using an income approach to value. §107.4 (a)(13)(D)(i)

Information Requests. This bill expressly requires that private contractors provide certain documentation, if requested by the assessor, specifically, the military’s request for proposal on the initial project, the private contractors winning submission, and the executed lease as well as any other binding documents. §107.4(b)(1)

For leases entered with the military on or after January 1, 2008, if requested, the private contractor must also provide the assessor with the projected property tax savings estimate over the term of the lease, how the estimate was made, the community and housing improvements to be constructed, and in certain cases the projected scope of the housing project. §107.4(b)(2)

Operative Date. These provisions are applicable to military housing projects for which a private contractor entered into a lease agreement with the military on or after January 1, 2006. §107.4(c)

Escape Assessment – Burden of Proof. Section 2 of this bill includes noncodified language that provides that if the assessor has not assessed a private contractor's possessory interest in military housing pursuant to Section 107.4, and ultimately that private contractor does not expend the resulting property tax savings on improvements within the required time period, the property will be assessed for that particular year via an escape assessment. If the private contractor appeals the escape assessment with the local assessment appeals board, then the private contractor will have the burden of proving that it did comply with all the provisions of Section 107.4(a)(13) and should be granted the exemption for that year, where the assessor submits a statement that to the best of his or her knowledge the private contractor has not satisfied the requirements of Section 107(a)(13).

In GENERAL

In certain instances a property tax assessment may be levied when a person or entity uses publicly-owned real property that, with respect to its public owner, is either immune or exempt from property taxation. These uses are commonly referred to as "taxable possessory interests" and are typically found where an individual or entity leases, rents or uses federal, state or local government property.

Revenue and Taxation Code Section 107 sets forth the three essential elements that must exist to find that a person's use of publicly-owned tax-exempt property rises to a level of a taxable possessory interest. The use must be independent, durable and exclusive of rights held by others in the property.

Section 107(a)(1) defines "independent" to mean "the ability to exercise authority and exert control over the management or operation of the property or improvements, separate and apart from the policies, statutes, ordinances, rules, and regulations of the public owner of the property or improvements. A possession or use is independent if the possession or operation of the property is sufficiently autonomous¹ to constitute more than a mere agency."

Property Tax Rule 20(c)(8), a regulation, additionally require that a possessor derive "private benefit" from the use of the property. "Private benefit" means "that the possessor has the opportunity to make a profit, or to use or be provided an amenity, or to pursue a private purpose in conjunction with its use of the possessory interest. The use should be of some private or economic benefit to the possessor that is not shared by the general public."

Section 107.4 provides a possessory interest exemption for a private contractor's interest in rental military *family* housing, by stating that the contractor's interest in the property is not "independent" when certain criteria are met. Thus, if qualified, these interests will deemed to be a *taxable* possessory interest.

LEGISLATIVE HISTORY

In 2004, Senate Bill 451 (Ch. 853, Ducheny) added Section 107.4 to provide that a possession or use of land or improvements is *not* independent if that possession or use is pursuant to a contract, including, but not limited to, a long-term lease, for the private construction, renovation, rehabilitation, replacement, management, or maintenance of

¹Property Tax Rule 20(c)(5) specifies that "to be sufficiently autonomous to constitute more than a mere agency, the possessor must have the right and ability to exercise significant authority and control over the management or operation of the real property, separate and apart from the policies, statutes, ordinances, rules, and regulations of the public owner of the real property."

housing for active duty military personnel and their dependents, if specific criteria are met. An interest that is not independent fails to meet one of the three necessary elements for the interest to be subject to property tax. Thus, a private contractor's interest in military housing meeting the eligibility criteria of Section 107.4 would be exempt from property tax.

In 2006, Senate Bill 1400 (Ch. 251, Kehoe) added subdivision (o) to Section 107.4 to define the phrase "military housing under military control" as a military base that restricts public access to the military base. SB 1400 clarified that privately-developed military housing not located on a military base does not qualify for the military housing possessory interest tax exemption. Shortly after enactment of Section 107.4, concern arose that the statute might not adequately define the term "military housing under military control," and that more expansive interpretations of the military housing possessory interest exemption might be advanced by developers of off-base military housing. The definition refinement was made to avoid an interpretation that Section 107.4 exempts all privatized military housing from the possessory interest tax by creating the bright line test of restricted public access. San Diego County sponsored the legislation because they have a number of privatized military housing projects, some of which are eligible for exemption and others which are not.

BACKGROUND

Congress established the Military Housing Privatization Initiative (MHPI) in 1996 as a tool to help the military improve the quality of life for its service members by upgrading the condition of their housing. The MHPI was designed and developed to attract private sector financing, expertise and innovation to provide necessary housing faster and more efficiently than traditional military construction processes would allow. The military enters into agreements with private developers selected in a competitive process to own, maintain and operate family housing via a fifty-year lease. The Department of Defense maintains an extensive website on the MHPI program at <http://www.acq.osd.mil/housing>.

In 2003, Congress authorized the Department of the Navy to undertake up to three pilot projects for the privatization of unaccompanied housing (i.e., bachelor housing). The various services call unaccompanied housing by different names, such as bachelor enlisted quarters, barracks and dormitories. The Navy selected Clark Pinnacle to redevelop Naval Station San Diego as part of the first large-scale public-private venture to provide housing for single military personnel. The Clark Pinnacle proposal was selected through competitive bidding. Clark Pinnacle is a partnership between Clark Realty Capital, a real estate and construction company headquartered in Bethesda, Md., and Pinnacle, a real estate investment management firm headquartered in Seattle. Construction broke ground in January 2007 and was completed in March 2009.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by San Diego County. Its purpose is to ensure that the private contractor's interest in bachelor housing is also eligible for exemption from property tax under Section 107.4. In addition, to administer the provision of the exemption, which requires that the property tax savings conferred by the state of California be passed through to the residents of the military housing project, this bill expands and provides greater details regarding the administration of those provisions. The county notes that this bill is codifying written agreements the county has made with some private contractors currently operating military housing

projects in San Diego that have been granted the taxable possessory interest exemption.

2. **The first project to privatize bachelor housing is located in San Diego.** The first pilot project, Pacific Beacon LLC, privatizes 258 units of Navy-owned unaccompanied housing units (Palmer Hall) and provides for the construction of 941 apartments at Naval Station San Diego (Pacific Beacon). The LLC will own, operate, and manage the project for 50 years.
3. **Pacific Beacon is now complete and ready for occupancy.** A March 26 press release states: "The Department of the Navy and Clark Realty Capital celebrated the grand opening of Pacific Beacon today at Naval Base San Diego. As the nation's first large-scale privatized housing community for unaccompanied military personnel, Pacific Beacon sets a new tradition in excellence by offering luxury living to single service members stationed in the San Diego metro area. The three luxury high-rise residences will serve as home to over 1,800 unaccompanied service members stationed in the San Diego metro area. Developed through a public-private venture between the Department of the Navy and Clark Realty Capital, Pacific Beacon opened its first building to residents in December of 2008. The entire project achieved substantial completion on March 12, 2009. The community constructed by Clark Construction Group and Clark Builders Group features 941 dual master suites and unique, resort-style amenities that rival any luxury high-rise apartment building in San Diego. The units are all priced at or below the Basic Allowance for Housing (BAH) rates of qualified residents." www.pacificbeacon.com
4. **California provides a property tax exemption - provided the residents are the ultimate beneficiaries of the exemption rather than the private contractor.** In 2004, Senate Bill 451 (Ch. 853, Ducheny) provided a property tax exemption to the developers and operators of the housing projects, but only if the private contractor passes through the property tax savings to the residents. Private contractors, who bid for projects, are informed that the projects could be subject to property taxes by the various local governments where the properties are located. According to the Department of Defense, the property tax implications of these projects are not guaranteed. The website for potential bidders notes: "Are property taxes considered in these deals? Although DoD will not negotiate with the local jurisdiction on any tax abatements, the developer is free to negotiate to achieve any tax abatements." <http://www.acq.osd.mil/housing/faqs.htm#27>
5. **Property tax savings are to inure to the benefit of the military families and service personnel rather than to the private contractor.** Current law requires that any reduction in property taxes on leased property used for military housing under the MHPI will inure solely to the benefit of the residents of the military housing through improvements, such as a child care center provided by the contractor. Other sections of law extending a property tax exemption to an otherwise non-tax exempt entity similarly require that property tax savings inure to the worthy organization in question, via rent reductions. (See Section 202.2 related to property leased to a public school, university or college or leased to a library or museum that is free to the public, and Section 206.2 related to property leased to churches). In this case, rather than reducing the rents charged to service personnel, the contractor is to insure that the property tax savings are used to provide additional improvements.

6. **This bill expands upon the types of improvements upon which the property tax savings can be used.** The property tax savings can be spent on either community improvements (like a recreation center or a child care center) or housing improvements including building more rental units for military personnel (but must be more than the minimum number required by the military). The savings can also be spent on renovating and refurbishing the community improvements or the housing improvements. The bill also specifies that the property tax savings from any one year is to be spent within 4 years. In addition, the property tax savings that will be realized over the term of the lease (typically 50 years) can be used to construct (or secure financing for) community or housing improvements as part of the “initial construction of the project.” For example, if the contract only required that 500 homes be built, but because of the projected property tax savings the contractor was able to build 550 homes, that could be an allowable use of the property tax savings that benefits the residents, since 50 more families can rent homes on the military base.
7. **Technical Amendment.** It appears that “family” should be struck on page 5, line 20:
- “(14) The military ~~family~~ housing is constructed, renovated, rehabilitated, remodeled, replaced, or managed under the Military Housing Privatization Initiative, or any successor to that law.”
8. **Related Legislation.** AB 1344 (Fletcher) also proposes amendments to Section 107.4.

COST ESTIMATE

The Board would incur insignificant costs (less than \$10,000) to inform and advise county assessors, the public, and staff of the change in law.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

Under the MHPI Act authorized by Congress in 1996, the military has made significant progress in privatizing on-base family housing units. Although the specifics of the implementation plans developed by the Army, the Air Force and the Navy, including the Marine Corps, vary, the basic framework of their deals is very similar:

- Lease land to private contractor/developer for 50 years.
- Convey existing family housing units and infrastructure to the contractor/developer for replacement or renovation.
- Contractor/developer to build additional family housing units, as required.
- Contractor/developer will be responsible for property management, including repairs and maintenance.
- Tenant costs, including utilities, may not exceed basic allowance for housing (BAH).
- At the end of the contract, the military authority will own the housing units.

In 2003, Congress authorized the Department of the Navy to undertake up to three pilot projects for the privatization of unaccompanied housing. The first pilot project, Pacific Beacon, privatized 258 units of Navy-owned unaccompanied housing units and provided for the construction of 941 apartments at Naval Station San Diego. The

ground-breaking ceremony for the project was held in January 2007; the project was completed in March of 2009.

The assessed value for the Pacific Beacon project upon its scheduled completion was projected to be \$100 million. The annual revenue impact was estimated to be \$1.0 million.

$$\$100 \text{ million} \times 1\% = \$1.0 \text{ million}$$

This project has been completed but has not yet been assessed; therefore, the actual revenue reduction for 2009 is not yet determined.

REVENUE SUMMARY

The estimated annual revenue impact from the Pacific Beacon project is \$1.0 million. Since the project has not yet been assessed at this time, the actual revenue impact has not yet been determined.

Qualifying Remarks. Depending on the success of the pilot unaccompanied housing privatization projects, Congress may decide to authorize the privatization of other unaccompanied housing quarters as well. The revenue impact of this bill would increase significantly if all such housing quarters were privatized.

Analysis prepared by:	Rose Marie Kinnee	(916) 445-6777	5/06/09
Revenue estimate by:	Richard Hagaman	(916) 445-0840	
Contact:	Margaret S. Shedd	(916) 322-2376	

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